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SUBJECT: GAO VISIT ON FRENCH FDI REGIME AND PRACTICES

¶1. (U) SUMMARY: French interlocutors confirmed to the GAO (during the visit of a GAO team to Paris from July 2 through July 5) that France welcomes Foreign Direct Investment despite a 2005 decree regulating FDI in sensitive sectors. The screening process implemented subsequent to the decree did not result in the rejection of any foreign investment deals in 2006. The government remains intent on attracting FDI to boost economic growth and job creation. That said, President Sarkozy, who recently called for a more activist EU industrial policy, could take a more aggressive stance in promoting France's national "champions" and interests (septel). End Summary.

GAO Visits Paris to Study French FDI Regime

¶2. (U) Three members of the Government Accountability Office (GAO) visited Paris July 2-5 to conduct a study of how France regulates Foreign Direct Investment (FDI), and how it implements Decree 2005-1739 of 30 December 2005 regulating FDI in eleven "sensitive" sectors (see paragraph 16). The GAO team met with Paris Embassy officers, the Prime Minister's Technical Advisor for International Economic Affairs, French Finance Ministry officers handling FDI regulations and financial issues, the Chairman of Invest in France "Agence Francaise pour les Investissemnents Internationaux AFII", the U.S. Managing Director of the American Chamber of Commerce in France, OECD senior analysts and U.S. law firms in Paris.

The FDI Regime in 11 Sensitive Sectors

¶3. (U) According to Finance Ministry specialists, adoption of a 2005 decree that defined eleven FDI sectors as sensitive was an attempt to provide additional transparency, rather than a significant change in policy. (OECD officials told the GAO that defining sensitive sectors was necessary for predictability and transparency -- "what was tacit is now visible.") An unofficial list of sensitive sectors had existed before the 2005 decree. French interlocutors described France's investment regime as "transparent", "open", "business-friendly" and "predictable." As evidence they pointed to the significant share of the French CAC 40 index held by foreign investors (more than 46.0 percent in 2006).

¶4. (U) In the French FDI regime there is no generalized screening of foreign investment; only acquisitions involving sensitive sectors are screened. The 2005 decree changed the triggers for government scrutiny in those sectors, stating that any investment granting control of a firm, or surpassing a 33 percent stake, or involving a branch of a firm headquartered in France, is subject to government review. The 2005 decree introduced a distinction between EU investors and non-EU investors, with a less restrictive regime

applying to the former.

¶5. (U) France normally considers firms established or incorporated in other EU countries, and owned or controlled by U.S. residents, as non-EU firms. To determine if non-EU investors control a firm, the French government looks at the residency of the headquarters and the ability of non-EU investors to veto key management decisions or commercial ties (such as loans, guarantees, options, licenses, or contracts) that might effectively make the French company dependent on foreign investors.

In Practice

¶6. (U) French officials said that the screening process is not expensive or burdensome. Investors are required to respond to a 2.5-page questionnaire providing information outlined in a March 7, 2003 order that implements decree 2003-196 on financial relations with foreign countries. Investors applying for screening are automatically approved if they do not receive a reply from the Finance Ministry in a two-month period.

¶7. (U) The period can be extended when more information is required. In such cases the two month clock does not begin ticking until the Finance Ministry has all the information it requires about a transaction. The Finance Ministry maintains an open dialog with the would-be investor as it seeks a complete understanding of the application. Every Finance Ministry decision can be appealed in the French courts and can be challenged before the European Court of Justice. Only 30 cases were examined by the Finance Ministry in 2006 (of 565 overall planned transactions reported by AFII) and all were approved. The Finance Ministry is aware of two rejections in the last ten years, both involving transactions related to defense matters. Quizzed about the French attitude toward foreign state-owned companies, French government officials said that France is more concerned by hedge funds than by sovereign wealth funds, but

concerns exist about both.

¶8. (U) The Finance Ministry team reviewing files is small, essentially concentrated in the "Multicom 2" office of the Finance Ministry's "Direction Generale du Tresor et de la Politique Economique" (DGTPE). However, some investments in sensitive sectors require the consensus of several ministries, including the Defense Ministry. The Finance Ministry may make arrangements with investors (as was the case for investments in Thales and EADS) such as predicating its agreement on commitments for investors to maintain production and employment in France, or to respect existing government contracts. (Quizzed by the GAO about the dual citizenship of employees working for firms with classified defense contracts, the Finance Ministry responded that the dual citizenship has only rarely been an issue of contention.) The Finance Ministry underscored that France is favorable to FDI, and the government's objective is a "business-friendly regime with more predictability."

Mergers and Acquisitions

¶9. (U) In response to GAO questioning, Finance Ministry officials indicated that the Finance Ministry is not automatically involved in mergers and acquisitions. However, the ministry may be involved when the government uses its "golden share" in state-owned firms to protect national interests. The golden share generally gives the government rights to require prior authorization from the Finance Ministry for any investor or group of investors acting in concert to own more than a certain percentage of a firm's capital; to name up to two non-voting members to the firm's board of directors; and to block the sale of any assets. Golden shares are not targeted at foreign investors, the officials claimed. Although energy is not currently a sensitive sector as defined in the 2005 decree, the officials raised as an example Gaz de France, in which the government might use a golden share to oppose any measure that could jeopardize the security of energy supplies.

¶10. (U) The GAO team was also interested in any regulations related to mergers and acquisitions in the banking and insurance sectors.

Finance Ministry interlocutors said there was no cap on FDI in either sector, but that mergers and acquisitions require the approval of the banking authority ("Comite des Etablissements de Credit et des Entreprises d'Investissement - CECEI") or the insurance authority ("Autorite de Controle des Assurances et des Mutuelles - ACAM").

Comments on France's and U.S. Investors' Images

¶11. (SBU) In an aside one official said he thought that the 2005 decree on sensitive sectors had not been necessary, given that the government had other rules at its disposal (e.g. taxes, norms, local regulations etc.) to derail undesirable FDI. The decree had created "a bad image" and sent "a protectionist message," he thought. (Note: According to the 2006 American Chamber of Commerce-Bain & Company Barometer, major factors that tarnish France's investment image include the 35-work week, as well as high income and social taxes. End note.) The AFII (which assists foreigners with French investment procedures) director stated that the lengthy process to receive visas and official approvals, including work papers and social security documents, can also discourage investment.

¶12. (U) While today's foreign investors face less interference than before, France has not entirely overcome a sometimes reflexive opposition to foreign investment. A lawyer who frequently represents foreign investors told the GAO team that the French public has a negative perception that U.S. firms have "tough" management policies, focusing on short-term profits at the expense of employment.

Possible Directions of Sarkozy's Policy

¶13. (U) The managing director of the American Chamber of Commerce in Paris predicts that the FDI regime will be more open with President Sarkozy. According to the AmCham, France is able to compete and has already showed it can adapt quickly to new technologies. Other participants in the GAO meetings said they expected France's FDI regime to remain open, given President Nicolas Sarkozy's pragmatism and his awareness of the benefits to France of FDI. Sarkozy is seen as likely to continue previous government efforts to attract FDI to France to spur economic growth and job creation. However, some interlocutors cautioned that he could be attracted by business-unfriendly policies that seek to protect employment against outsourcing.

¶14. (SBU) The Prime Minister's Technical Advisor did not foresee any major change in FDI policy in the next few months, except in the energy sector. FDI in the energy sector is likely to be part of a broad internal EU discussion, and may become a national security issue in the future. A private consulting firm representative interpreted Sarkozy's recent calls for an EU industrial policy as foretelling of a "presidentialization" of the FDI regime to promote France's national interests. The Finance Ministry expects the French government to have an intra-EU debate on FDI issues.

The EU and the French FDI Regime

¶15. (U) The European Commission initially questioned whether the 2005 FDI decree respected the free circulation of capital, or the freedom of establishment within the EU. According to the Prime Minister's adviser, French FDI regulations should not make any difference between "pure" EU companies and EU companies that may be controlled or owned by non-EU investors. Though the PM's adviser did not raise the question of revisiting that issue, an AFII legal specialist predicted a solution would be found at the EU level for rules pertaining to FDI by EU companies, including those which are controlled or owned by non-EU investors.

The Eleven Sensitive Sectors

¶16. (U) The 2005 investment decree applies broadly to "activities," so an investor has to be cognizant about getting approval for investment even if only tangentially involved in one of the defined sectors. The eleven categories are:

-- activities involving gambling (gambling was added to the initial 10-sector list officially to fight against money laundering and prevent addiction to games, though most observers say it was to protect local economic and political interests);
-- activities concerning private security, specifically where security is provided to: an operator of vital importance, civil aviation or maritime ports and zones where national defense secrets are kept;
-- activities involving the research, development or production of means to combat the illicit use by terrorists of pathogenic or toxic agents, or to prevent the health consequences of such use;
-- activities concerning material used for the interception of communications and for eavesdropping;
-- activities related to centers of evaluation for security certification of computer products or systems;
-- activities related to goods or services of computer system security used by public or private operators of defense installations;
-- activities related to dual-use technologies, as defined by EU regulations 1334/2000 of June 222, 2000;
-- activities related to cryptology resources, as well to cryptology for ensuring confidence in the digital economy;
-- activities exercised by firms that are depositaries of national defense secrets;
-- activities of research, production or sale of arms, munitions, powders and explosive substances destined for military use;
-- activities exercised by firms that have concluded contracts for study or for providing equipment for the Ministry of Defense, either directly or by subcontractor, for any of the goods or services listed above.

Comment

¶17. (U) The GOF, and Minister of Economy, Finance and Employment Christine Lagarde in particular, is aware that France has to improve its attractiveness to investors, rather than introduce measures which could appear to be impediments to investment. According to a recent Ernst and Young analysis, France's ability to create new national "champions" is limited and it will increasingly require FDI to drive economic growth.

¶18. (U) The GAO delegation has cleared this cable.

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